Secured Finance Network

March 9, 2022

TO: Committee on Banking of the General Assembly of the State of Connecticut

RE: Raised Bill No. 272 An Act of Requiring Certain Financing Disclosures (“Proposed Legislation”)

Dear Co-Chairs Senator Miller and Representative Doucette, Ranking Members Senator Berthel and Representative Delnicki and Distinguished Members of the Banking Committee,

The Secured Finance Network, Inc. (“SFNet”) www.sfnet.com is the international trade association, founded in 1944, representing the asset-based lending, factoring, trade and supply chain finance industries, with over 280 member organizations throughout the U.S., Canada and around the world. Many of these organizations are located in Connecticut and many more provide financial services to Connecticut-based companies. In total, these organizations have an estimated $14B in capital deployed to businesses in the state. Although the Proposed Legislation has implications with respect to many forms of financial products, we specifically direct you to its implications with regard to factoring and asset-based lending transactions.

Exemption for Factors and Asset-Based Lenders

SFNet and its membership are supportive of providing as much information as possible to small businesses in order to assist them in making as an informed decision as possible as to which financing products or proposals are best suited for them. However, we are concerned with the breath of the bill in its current form as it captures a large portion of the commercial lending industry that, as a matter of industry practice, already provides a great deal of transparency into the credit facilities it provides. In this regard asset-based lending and factoring are well established products whose providers have practiced fair business disclosures over our Association’s 75-year history. Specifically, our members currently supply disclosure information to prospective borrowers in the form of detailed written term sheets which are specific to the type of financial product being requested. It is standard industry practice to provide the terms of the facility to prospective borrowers and obtain the prospective borrower’s signature on the term sheet before formally entering into any credit facility. These term sheets provide sufficient information as to properly inform the prospective borrowers of the anticipated cost of the facility.

Unfortunately, the Proposed Legislation provides for a disclosure protocol, particularly with regard to the APR metric, which distorts in some cases and inadequately describes in other cases the “true” cost of the financial product. Therefore, it is our request that there be an exemption from the bill for those factors and asset-based lenders that execute a detailed written term sheet with the prospective borrower while requiring that those factors and asset-based lenders that do not have written and acknowledged term sheets be included in the disclosure requirements in a manner that they can comply with.

As it relates specifically to the provisions of the Proposed Legislation, SFNet and its members strongly object to certain of its provisions and the lack of other provisions (as enumerated below) and urge the Committee on Banking to take our comments and suggested solutions into account when considering the Proposed Legislation.

The Inapplicability of APR

The single most challenging and unnecessary provision of the Proposed Legislation as it relates to the disclosures proposed for factors and asset-based lenders is the requirement that an annual percentage rate (“APR”) be calculated and disclosed not as a commercial transaction, which it obviously is, but in accordance with the Federal Truth-In Lending Act (Regulation Z, 12 C.F.R. Section 1026) statue which applies solely to consumer transactions. As a result, the APR calculation as currently written does not disclose the “true” cost of the financing sought by the prospective borrower.

Factoring and asset-based lending are each financial products that only offer “open ended” revolving advances to their clients yet the proposed legislation inexplicably requires that factors and asset-based lender disclose APR as if these facilities were “closed end” term loans, which is a completely different product (See Appendix J of Part 1026 of the Truth in Lending Act).

SFNet using a hypothetical discount factoring transaction as its initial attempt at trying to calculate APR in accordance with the Proposed Legislation has spent a significant amount of time and resources trying to come up with a precise calculation of APR. Needless to say we found it extremely difficult to follow the definitions and methodology of a consumer disclosure statute and therefore are convinced that unless clarified in the Proposed Legislation, there will be a range of disparate APR calculations which are, however, based upon the same financial terms, thereby defeating the goal of the Proposed Legislation.

Servicing Fees

Certain factors and asset-based lenders charge their clients separately for the servicing of their client's accounts and for the extension of credit as opposed to a single fee charged by other factors, such as discount factors, which charge a single fee for both the discounting and servicing of their client's account. Specifically, the former category of factors and asset-based lenders charge one fee for servicing, including the ledgering of the client's accounts, credit investigation and collection services and different and wholly separate fee if there is an extension of credit by the factor or asset-based lender.

We read Section 1026.4 (b) (2) of Regulation Z of the Truth in Lending Act which governs the calculation of APR for purposes of the Proposed Legislation to exclude these servicing fees from the calculation of the Finance Charge and therefore from the APR calculation as these fees are not incident to a condition of the extension of credit. SFNet seeks clarification on this interpretation of the Proposed Legislation.

Post Transaction Disclosures

It would appear from the Proposed Legislation that disclosure will be required subsequent to the consummation of the commercial financing contract if the contract is "changed" and the resulting change would increase the Finance Charge.

Factoring and asset-based credit facilities are designed to provide working capital for the borrowers and therefore these facilities have to adapt to the working capital needs and fluctuations of the borrower. Because of the need to have the ability to adapt, "changes" to these financing arrangements may occur often during the term of the financing. Requiring the factors and asset-based lenders to constantly re-disclose appears to be required by the Proposed Legislation will be burdensome to the financing provider and create confusion for the borrower. For example, a temporary need for additional capital under the financing contract may result in the recipient requesting that the provider increase its lending to provide this additional capital. In that situation, the loan documents/factoring agreement may or may not need to be amended and the provider may charge an immaterial accommodation or amendment fee. However, in such a situation, the recipient most likely will not be looking to multiple sources of financing to compare the best product available and therefore a re-disclosure does not provide any useful information for the borrower to compare against other financings.

SFNet understands that the public policy behind the Proposed Legislation is to provide information to small businesses so that these small businesses may make informed decisions on the types of financing available to them. However, the requirement for re-disclosure for only a minor or temporary change in a single term of the loan document or factoring agreement without additional parameters does not, in our opinion, comport with this public policy.

We therefore propose several alternatives in which the re-disclosure requirement may be tailored to provide more useful information to the recipient.

(1) Changes in Writing. Generally, accommodations made to the recipient during the "life" of the finance or factoring transaction are documented in writing when they are material changes to the financing or factoring transaction.

Limiting the re-disclosure requirement to written changes to the finance or factoring documents would make the re-disclosure requirement more meaningful to the recipient as it would capture material changes to the financing.

(2) Exclusion for Ordinary Course Changes. As discussed above, all small businesses will have ebbs and flows and financing provided to such businesses will have to adapt to these changes. There will be ordinary course modifications to a factoring facility or asset-based facility which should not trigger a re-disclosure as these changes could happen often and create a burden on the provider and confuse a small business at a time when the small business is not looking for new financing or the ability to compare one financing product against another product. Furthermore, the potential time delay in providing these disclosures could worsen a small business' situation as circumstances often arise in the "life" of a financing that require almost immediate action on the part of the provider and small business to address the circumstance or risk worsening the business' situation. We request an exclusion for re-disclosures related to changes in the financing if the changes are in the ordinary course of business.

(3) Material Changes. Similar to the above suggestions, a materiality threshold would help limit confusion as frequent (sometimes daily) changes to the financing which do not result in a material change to the financing charge would not need to be disclosed even if it increased the cost of the financing. We request that Proposed Legislation limit the requirement to re-disclose to changes which materially increase the APR resulting from such changes greater than a certain percentage.

(4) Excluded Avoidable Fees and Expenses. During the "life" of a financing, there are many instances in which additional fees and expenses may be charged to the recipient due to the actions of the recipient. For example, the recipient may fail to comply with covenants set forth in the financing documents and request that its failure be waived by the provider. In such situations, the provider may charge a waiver or amendment fee to obtain credit approval and document the waiver. Such fees and expenses could have been avoided by the recipient by simply complying with the terms of the contract. In this instance, a re-disclosure is unnecessary, and we believe not in line with the public policy of the Proposed Legislation. We request that an exception be included in the Proposed Legislation for re-disclosure due to an increase in the financing charge due to the charging of avoidable fees that the recipient fail to avoid.

Finally, many of the providers lending to small businesses are themselves small businesses and an open-ended requirement to re-disclose changes to a financing transaction creates a potential material burden on these small businesses resulting in operational challenges for the smaller providers. We would hope that the regulations would protect all small businesses and not one group of small businesses to the detriment of other small businesses.

Non-Borrowing Factoring Facilities

There are factoring transactions that are “non-borrowing” meaning that the provider does not lend or advance any funds against the recipient’s accounts receivable. The trade terminology for these types of factoring transactions is sometimes referred to as “collection factoring”. In these types of transactions there is no credit extension to the factored client and thus there is a $0 approved advance limit.

In this type of transaction, a factoring fee is charged to the recipient as consideration for invoice management or “back office” services, which typically include ledgering services, credit risk assessment services in respect of the client’s customers to whom goods are being sold or services are being rendered and collection services relating to pursing payment from account debtors, however, no funds are being advanced by the factor against the accounts receivable.

Without a change to the Proposed Legislation, the factor engaged in collection factoring would still be required, because the approved advance limit would be less than $500,000, to make the various disclosures required by the Proposed Legislation. SFNet believes that this is not consistent with the policy of the Proposed Legislation.

Non-Recourse Factoring

SFNet requests that non-recourse factors be excluded from the disclosure requirements of the Proposed Legislation.

In a non-recourse factoring transaction, the recipient sells one or more of its accounts to the factor who assumes the full credit risk and must pay the recipient the full contractual purchase price for each such account purchased without the right of charge back if the account does not collect in full on a timely basis due solely to the post purchase occurrence of a credit risk event previously assumed by the factor.

This transaction represents a sale of the small business owner’s accounts for a fee and is neither an extension of credit nor an advance and therefore should be excluded from the reach of the Proposed Legislation.

Affiliated Recipients

Commercial financings are often provided to related borrowers or co-borrowers. The test as to whether the disclosure requirements applies should be at the aggregate level for borrowers related by common ownership, not at the individual borrower level. For example, assume the approved advance limit for one recipient is $600,000 and for a related recipient the approved advance limit is $200,000. Under our interpretation of the Proposed Legislation, the first borrower would not need to be provided the disclosure, but the second would. The proposed change would eliminate the requirement for the second borrower, which is appropriate from a policy standpoint given that the two recipients in this example are related by common owners and the Proposed Legislation does not require the disclosure for the recipient that has the larger approved advance limit. Thus, the protections afforded by the disclosure are not needed for the second borrower.

Safe Harbor

Because of the numerous estimates and assumptions that are required to be provided for the APR calculation, even the most diligent attempts at calculating the APR could easily result in a significant margin of error.

Therefore, SFNet requests the following changes to the Proposed Legislation:

(1) Include a safe harbor for providers of commercial financing to small businesses who inaccurately calculate APR provided the calculation is made in good faith. This would be very similar to safe harbor contained in the Federal Truth-In Lending Act for consumer lending disclosures (see 15 U.S.C. Sec. 1640(b) and 15 U.S.C. Sec. 1640(c)); and

(2) Provide that the APR calculation disclosed by the provider shall not serve as either a basis for any claim against the provider or evidence of criminal or civil usury.

Postponement of Effective Date of the Proposed Legislation

SFNet believes that the effective date of the Proposed Legislation should be extended to a date that is twelve months after the adoption by the Banking Commissioner of final regulations to the Proposed Legislation. This extension is necessary as currently the specific offers made by our members to their proposed borrowers are not compliant with the proposed regulations and our members need time to change their business practices in order to adopt a disclosure regime which complies with the Proposed Legislation.

Thank you for the opportunity to provide our comments on the proposed regulations. We look forward to further discussions regarding these important considerations.

Respectfully,

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